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TREASURY FOR OASIA/DOHNER, CUSHMAN

E.O. 12958: N/A
TAGS: ENRG EINV ECON EPET EFIN CH

SUBJECT: CHINA/ENERGY: CHINA CUTS FUEL PRICES

SUMMARY

¶1. (SBU) The Chinese government announced significant energy price cuts December 18, marking the first change in domestic fuel prices since international crude prices began to fall from their mid-summer peak. As of December 19, refinery gate prices for gasoline, diesel, and aviation fuel were reduced by 13.9 percent, 18.1 percent, and 32.2 percent respectively. The price cuts took place in the midst of a broader pricing policy reform and arrived ahead of fuel tax increases, which are scheduled to take effect on January 1. While China's energy prices remain government controlled, the moves are part of a broader effort to shift toward a more market-driven energy pricing system that will allow state-owned refineries to better minimize losses when global oil prices surge. Although government statements also assert the fuel pricing and tax reforms aim to help reduce greenhouse gas emissions by making consumers more sensitive to market price fluctuations, it is unclear how lower fuel prices will discourage vehicle use. END SUMMARY.

FUEL PRICE REDUCTION PART OF BROADER PRICING REFORM
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¶2. (SBU) China's National Development and Reform Commission (NDRC)Pricing Bureau announced significant energy price cuts on December 18. As of December 19, refinery-gate prices for gasoline were reduced by 13.9 percent from RMB 6,480 to RMB 5,580 per metric ton; diesel prices were reduced by 18.1 percent from RMB 6,070 to RMB 4,970 per ton; and aviation fuel prices went down by 32.2 percent from RMB 7,450 to RMB 5,050 per ton. The price cuts took place in the midst of a broader pricing policy reform and arrived ahead of fuel tax increases, which are scheduled to take effect on January 1. Consumers had been expecting fuel prices to decrease in the coming weeks, as the government had ensured consumers on December 5 that fuel tax reforms would not result in increased prices at the pump.

¶3. (SBU) Current fuel price reforms reflect government efforts to move toward a more market-driven pricing system that will reduce losses by state-owned refineries when global oil prices rise. The reforms also intend to reduce greenhouse gas emissions by making consumers more sensitive to price fluctuations. According to government announcements, under the new pricing system domestic retail fuel prices will be based on international crude prices, ex-factory prices of gasoline and diesel, average

domestic processing costs, taxes, and a "reasonable margin" for refineries.

¶4. (SBU) This week's price reductions mark the first changes in domestic fuel prices since global crude prices began to fall from their mid-summer peak. China last adjusted fuel prices on June 20, when it raised gasoline and diesel prices by approximately 17-18 percent in order to reduce shortages caused by refiners, which found it unprofitable to place fuel on the market as a result of rising global oil prices. Despite the fall in global crude prices over the last several months, Chinese regulators refrained from lowering domestic prices to allow state-owned oil companies to restore profitability following significant losses on refining operations earlier this year. China's two largest refiners, Sinopec and CNPC/PetroChina, rely heavily on oil imports and reported refining losses in the first half of 2008 despite receiving government subsidies to address the gap between international oil prices and domestic refined product prices.

FUEL TAX WILL TAKE EFFECT JANUARY 1

¶5. (SBU) The pricing changes come ten days ahead of significant fuel tax reforms, scheduled to take effect on January 1, 2009. Under the new tax system, six types of transportation fees will be eliminated, including a road maintenance fee paid by all vehicle owners. Toll collection on secondary roads will also gradually be phased out. Most importantly, tax on gasoline will increase fivefold from RMB .2 (USD .03) per liter to RMB

1.0 (USD .15) per liter and diesel tax will increase from RMB .1 (USD .01)per liter to RMB .8 (USD .12)per liter.

¶6. (SBU) An increase in gasoline and diesel consumption tax has been the most controversial aspect of the proposed tax reforms. During the period for public comment following the December 5 announcement of the reforms, more than 48,000 citizens (58.6 percent of them vehicle owners) submitted their views on the proposed taxes via a government-established web-based site. A government-affiliated Chinese academic told econoff this week that a large percentage of the respondents opposed the fuel tax. She pointed out, however, that vehicle owners generally have higher incomes and could more readily absorb higher taxes than people who do not own cars.

COMMENT: REDUCED EMISSIONS UNLIKELY

¶7. (SBU) According to econ contacts, one of the main goals of the planned fuel pricing and tax reforms is to reduce greenhouse gas emissions by making consumers more sensitive to prices through a "pay for what you use" system. However, even taking into consideration the scheduled tax increases, fuel costs are now lower than they have been for the past six months. It is unclear how this will discourage vehicle use. With a backdrop of high oil inventories, a struggling domestic auto market, and general uncertainty about the economy, a policy intended to curb energy consumption could stimulate it. End Comment.